

OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR AFGHANISTAN RECONSTRUCTION

**The World Bank and the Afghan Government Have
Established Mechanisms to Monitor and Account for
Funds Contributed to the Afghanistan Reconstruction
Trust Fund, but Some Limitations and Challenges Should
Be Addressed**



July 22, 2011

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July 22, 2011

The Honorable Hillary Rodham Clinton
Secretary of State

Dr. Rajiv Shah
Administrator
U.S. Agency for International Development

The Honorable James B. Cunningham
Charge d'Affaires, U.S. Embassy Afghanistan

Dr. S. Ken Yamashita
USAID Mission Director to Afghanistan

This report discusses the results of an audit of World Bank and Afghan government mechanisms to independently monitor and account for U.S. and donor funds contributed to the Afghanistan Reconstruction Trust Fund (ARTF), and the Afghan government's capacity to monitor and account for these funds. This report includes three recommendations to improve oversight and reporting on the use of U.S. and donor contributions to the ARTF, and to enhance the Afghan government's capacity to manage and account for ARTF funds.

A summary of this report is on page ii. When preparing the final report, we considered comments from the U.S. Embassy in Kabul and the World Bank. These comments are reproduced in appendices VI and VII, respectively. SIGAR conducted this performance audit under the authority of Public Law No. 110-181, as amended, the Inspector General Act of 1978, and the Inspector General Reform Act of 2008.

Herbert Richardson
Acting Special Inspector General
for Afghanistan Reconstruction



SIGAR

Special Inspector General for Afghanistan Reconstruction

SIGAR Audit-11-14

July 2011

The World Bank and the Afghan Government Have Established Mechanisms to Monitor and Account for Funds Contributed to the Afghanistan Reconstruction Trust Fund, but Some Limitations and Challenges Should Be Addressed

What SIGAR Reviewed

In 2010, the United States and other donors pledged to channel at least 50 percent of development assistance through Afghanistan's national budget within the next 2 years. Created in 2002, the multi-donor Afghanistan Reconstruction Trust Fund (ARTF) was originally intended to serve as a short-term source of direct assistance to finance Afghanistan's non-security related operating budget. It is now expected to close in 2020 and is increasingly funding development projects. As of April 2011, 32 donors had contributed \$4.29 billion to the ARTF; the United States has contributed almost \$972 million. This report assesses the extent to which (1) the World Bank and the Afghan government have established and implemented mechanisms to independently monitor and account for donor contributions to ARTF, and (2) the Afghan government has developed the capacity to monitor and account for ARTF funds. SIGAR conducted this performance audit in Kabul, Afghanistan, and Washington, D.C., from November 2010 to July 2011, in accordance with generally accepted government auditing standards.

What SIGAR Found

Donors rely on the World Bank, as the ARTF's administrator, to oversee and report on the uses and results of donor funding. The World Bank, a monitoring agent hired by the World Bank, and Afghanistan's Control and Audit Office (CAO) provide oversight of ARTF funds. The World Bank monitors, evaluates, and reports on development project results and uses of ARTF funds. The monitoring agent is responsible for monitoring the Afghan government's operating expenses. CAO audits Afghan government accounts and records, including accounts funded by ARTF. However, SIGAR found some limitations in these mechanisms. First, the monitoring agent's and CAO's reviews of ARTF funding for the Afghan government's operating budget are limited to financial reviews and financial audits, respectively, rather than performance audits that would allow them to examine and report on the efficiency and effectiveness of ARTF funding. Second, the monitoring agent has not conducted site visits outside of Kabul to monitor funds since March 2009, and World Bank and CAO monitoring outside of Kabul is limited. Thus, there has been little independent validation of ARTF spending outside of Kabul. For example, during its audit of Afghan government operating expenditures between March 2008 and March 2009, CAO auditors only visited 11 out of 34 provinces. Thus, the office did not audit about \$238 million, or 28 percent, of the Afghan government's \$845 million in total non-security operating expenditures to determine eligibility for ARTF reimbursement. Additional site visits outside Kabul would provide donors with more assurance that ARTF funds are being used in accordance with the fund's requirements. Third, the World Bank could improve its dissemination of reporting on the results and outcomes of ARTF-funded development projects. While some ARTF donors may receive detailed reporting on certain projects, others may not.

SIGAR found that Afghan ministries have generally increased their ability to manage and account for government finances, including ARTF funds. For example, ministries have established dedicated units to implement ARTF-funded development projects. Nevertheless, the Afghan government faces challenges developing and maintaining the civil service expertise needed to manage and account for ARTF funds. As a result of the capacity constraints, ministries continue to rely on Afghan contractors and international firms, which are paid using a portion of ARTF project funds. For example, CAO utilizes an international firm to provide technical assistance on ARTF-related audits. Due to difficulties developing the capacity of the civil service, the Afghan government may continue relying on non-civil service personnel to provide support in implementing ARTF-funded projects, which could slow progress in developing long-term civil service capacity.

What SIGAR Recommends

SIGAR is making two recommendations to the U.S. Ambassador to Afghanistan to urge the World Bank to take steps to (1) ensure that site visits to the provinces are conducted, on a sample basis, to verify the eligibility of the Afghan government's operating expenditures, and (2) enhance reporting to donors on ARTF-funded project results. In addition, SIGAR is making a third recommendation to the U.S. Ambassador to Afghanistan to continue efforts to enhance the Afghan government's ability to attract and retain qualified civil service staff to manage and account for development funding, including ARTF funds. In commenting on a draft of this report, the U.S. Embassy in Kabul and the World Bank noted steps that they will take to address these recommendations.

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ACRONYMS

ARTF	Afghanistan Reconstruction Trust Fund
CAO	Control and Audit Office
EQUIP	Education Quality Improvement Program
MoE	Ministry of Education
MoF	Ministry of Finance
MoPW	Ministry of Public Works
MRRD	Ministry of Rural Rehabilitation and Development
NERAP	National Emergency Rural Access Project
NSP	National Solidarity Program
PAM	Performance Assessment Matrix
PwC	PricewaterhouseCoopers-Netherlands
SIGAR	Special Inspector General for Afghanistan Reconstruction
USAID	U.S. Agency for International Development



The World Bank and the Afghan Government Have Established Mechanisms to Monitor and Account for Funds Contributed to the Afghanistan Reconstruction Trust Fund, but Some Limitations and Challenges Should Be Addressed

In 2010, the United States and other donors pledged to provide at least 50 percent of their development assistance through the Afghan government's national budget within the next 2 years. Many donors view the Afghanistan Reconstruction Trust Fund (ARTF) as the key mechanism for providing this direct assistance to Afghanistan. ARTF, created in March 2002, facilitates multi-donor direct assistance to support Afghanistan's financial and reconstruction needs in line with Afghan priorities. As of April 20, 2011, ARTF had received \$4.29 billion in contributions from 32 donors, with the United States contributing almost \$972 million—nearly 23 percent—of the total amount.¹

The United States and other donors rely on the World Bank, as the ARTF administrator, to oversee and report on the uses and results of ARTF funding, and to provide oversight of Afghan ministries receiving ARTF funds. However, U.S. and other officials have expressed concerns about ARTF oversight mechanisms, and the capacity of the World Bank and the Afghan government to oversee additional funds.

This report assesses the extent to which (1) the World Bank and the Afghan government have established and implemented mechanisms to independently monitor and account for donor contributions to ARTF, and (2) the Afghan government has developed the capacity to monitor and account for ARTF funds.

To accomplish these objectives, we reviewed and analyzed the U.S. Agency for International Development (USAID) grant agreement with the World Bank and data detailing U.S. contributions to the fund.² In addition, we analyzed World Bank quarterly ARTF reports to donors and monthly administrator's reports. We also examined the World Bank's ARTF grant agreement with the Afghan government, policies and procedures for project oversight, development project documents, contracts for a monitoring agent, and annual and quarterly monitoring reports. We also reviewed Afghanistan's national budgets and development project documents. In addition, we interviewed relevant U.S. officials at Embassy Kabul, World Bank and monitoring agent representatives, Afghan government officials, and Kabul-based representatives of 11 ARTF donors. We conducted our work in Kabul, Afghanistan, and Washington, D.C., from November 2010 to July 2011, in accordance with generally accepted government auditing standards. A discussion of our scope and methodology is in appendix I.

¹ The World Bank transferred a \$2.4 million contribution from the United Nations Development Program to a separate fund for the Afghan Interim Authority. Total contributions also include a \$21.6 million contribution to the Law and Order Trust Fund for Afghanistan.

² The United States provides contributions to ARTF through a grant from USAID to the World Bank.

BACKGROUND

The World Bank formally established ARTF in March 2002 in response to requests from the interim Afghan government and international donors for a multi-donor mechanism to support the Afghan government following the fall of the Taliban regime. With an initial closing date of June 30, 2006, the fund was originally intended to serve as the major, short-term source of direct assistance for financing Afghanistan's non-security related operating budget until the Afghan government could raise revenues to cover its own operating costs.³ However, since its inception, ARTF has increasingly funded development projects aligned with Afghan reconstruction priorities defined in the Afghanistan National Development Strategy. As a result, donors first agreed to extend the fund's closing date to June 30, 2010, and then later to June 30, 2020. ARTF's four main objectives are to:

- position the Afghan government budget as the key vehicle to align international reconstruction assistance with Afghan development objectives;
- promote transparency and accountability of reconstruction assistance;
- reduce the burden on an Afghan government with limited capacity while simultaneously promoting Afghan capacity building over time; and
- enhance donor coordination.

As of April 20, 2011, 32 donors have contributed approximately \$4.29 billion to ARTF.⁴ Of these donors, around 15 contribute regularly to the fund. The top five donors—the United States, United Kingdom, Canada, the Netherlands, and the European Union—account for over \$3 billion, or about 72 percent, of total contributions. As the largest donor, the United States has contributed approximately \$972 million to ARTF. Appendix II provides a breakdown of U.S. and donor contributions to ARTF, as well as a breakdown of U.S. contributions by funding purpose.

ARTF has two main funding types, or windows: Recurrent Cost and Investment.⁵ The Recurrent Cost Window finances the Afghan government's non-security related operating budget, which largely consists of payroll costs for Afghan civil servants, as well as some operations and maintenance expenditures. The Recurrent Cost Window funds these costs on a reimbursable basis up to a pre-determined funding cap. For the Afghan government to receive reimbursement for its operating expenditures, the expenditures must meet eligibility criteria defined in the ARTF grant agreement between the World Bank and the Afghan government. As of April 20, 2011, the Recurrent Cost Window had disbursed a total of about \$2.22 billion, of which approximately \$1.7 billion funded Afghanistan's payroll and \$532 million funded operations and maintenance expenditures. In December 2008, the World Bank, the Afghan government, and donors agreed to establish the Incentive Program within the Recurrent Cost Window. The Incentive Program provides the Afghan government with funding if it meets pre-defined benchmarks in such areas as revenue generation, public sector governance, and private sector development. For more information on the Recurrent Cost Window and Incentive Program, see appendix III.

³ International donors have largely funded Afghanistan's security-related budget, which includes military and police expenses, bilaterally and via the Law and Order Trust Fund for Afghanistan.

⁴ This includes a \$2.4 million contribution from the United Nations Development Program for the Afghan Interim Authority fund, and approximately \$21.6 million in pass-through funding to the Law and Order Trust Fund for Afghanistan.

⁵ When ARTF was first established, there were separate sub-funds for debt repayment, a pass-through to the Law and Order Trust Fund for Afghanistan, and the Afghan Expatriate Program and Lateral Entry Programs. These sub-funds are now closed, and the expatriate and lateral entry programs have been merged into a capacity building program under the Investment Window.

The ARTF Investment Window provides grant funding for development projects that support the national priority programs defined in Afghanistan's development budget.⁶ To date, the Investment Window has disbursed a total of about \$1.31 billion to fund 34 development projects, 19 of which were ongoing as of April 20, 2011.⁷ The largest ongoing projects are the National Solidarity Program (NSP) III,⁸ the Education Quality Improvement Program (EQUIP) II, and the National Emergency Rural Access Project (NERAP). Appendix IV includes more information on the Investment Window and ARTF-funded development projects. From March 2009 to March 2010,⁹ the most recent year for which complete data are available, ARTF funded approximately 15 percent of the Afghan government's core operating and development expenditures.¹⁰

ARTF has a three-tier governance structure. The Steering Committee, which consists of all ARTF donors, the World Bank, and the Afghan Ministry of Finance (MoF), is the main decision-making body for the fund. The Steering Committee meets quarterly to set ARTF policy and financing strategy, provide guidance to the ARTF Management Committee on fund allocation strategies, and review progress on ARTF activities.¹¹ The Management Committee meets monthly and is responsible for reviewing and approving funding allocations in line with the ARTF financing strategy, and reporting to donors on operations and activities financed by ARTF, as well as on decisions made by the committee.¹² The World Bank administers ARTF and is responsible for day-to-day fiduciary oversight and management of the fund, and for the supervision of development projects.¹³ This includes providing oversight of the Afghan ministries implementing ARTF-funded projects.

Like other ARTF donors, the United States relies on the World Bank, as the fund's administrator, to oversee the use of funds. Neither USAID nor other sections at U.S. Embassy Kabul independently oversee the use of U.S. funds contributed to ARTF. Further, per the agency's grant agreement with the World Bank, USAID has limited rights to audit U.S. contributions to the fund. However, to track ongoing ARTF activities and developments, USAID has assigned three agency personnel at the U.S. Embassy in

⁶ To prioritize the initiatives contained in the Afghanistan National Development Strategy, the Afghan government is developing 22 National Priority Programs. These programs represent Afghanistan's priority areas in different sectors that need greater investment from 2010 to 2013. These programs seek to create jobs, connect markets, and increase the social and economic well-being of the people. They also aim to strengthen security in different parts of the country and ensure a smooth transition of security from international partners to Afghan National Security Forces.

⁷ The 34 total ARTF-funded development projects include two police projects funded via a pass-through of ARTF funds to the United Nations Development Program-administered Law and Order Trust Fund for Afghanistan. In addition, some projects, such as NSP and EQUIP, have multiple phases, each of which is counted as a separate project.

⁸ See SIGAR Audit-11-8, *Afghanistan's National Solidarity Program Has Reached Thousands of Afghan Communities, but Faces Challenges that Could Limit Outcomes*, March 22, 2011.

⁹ The Afghan government's fiscal year is the solar year. Solar year 1388 began on March 21, 2009 and ended on March 20, 2010. The current fiscal year, solar year 1390, began on March 21, 2011 and will end on approximately March 20, 2012.

¹⁰ The Afghan government's budget is divided into the core and external budgets. The core budget tracks funds that flow through the Afghan treasury while the external budget includes expenditures directly expended by donors outside the treasury system. From March 21, 2009 to March 20, 2010, Afghanistan's solar year 1388, the core budget expenditures amounted to about \$2.66 billion. Of this, Afghanistan's revenue covered about 48 percent of expenditures while donor grants, including ARTF, funded about 51 percent of expenditures. This resulted in a fiscal deficit of \$41 million for the year.

¹¹ Two smaller donor working groups, the Strategy Group and the Incentive Program Working Group, engage with the World Bank and the Afghan government on more technical issues.

¹² The Management Committee consists of representatives from the World Bank, Asian Development Bank, Islamic Development Bank, United Nations Assistance Mission in Afghanistan, United Nations Development Program, and the MoF.

¹³ The World Bank receives an administrator's fee of 1.5 percent of ARTF contributions to fund its oversight of the fund. From the creation of ARTF in March 2002 through March 20, 2011, the World Bank had received a total of \$64.4 million in fees. In late 2010, donors endorsed increasing the fee to 2 percent, and in February 2011, the World Bank Board of Executive Directors approved the increase. World Bank officials expect this fee increase to take effect in July 2011.

Kabul to monitor the fund. In addition, the Office of the Coordinating Director for Development and Economic Affairs and the Treasury Attaché at the embassy have personnel who follow the fund.¹⁴

MECHANISMS ESTABLISHED TO INDEPENDENTLY MONITOR AND ACCOUNT FOR ARTF FUNDS HAVE SOME LIMITATIONS

The World Bank and the Afghan government have established mechanisms to independently monitor and account for ARTF funds; however, these mechanisms have some limitations. Oversight of ARTF funds consists of a combination of standard World Bank procedures for supervising World Bank-funded projects, a contracted monitoring agent for funds covering Afghanistan's non-security operating costs, and mandatory audits by Afghanistan's Control and Audit Office (CAO). However, monitoring of non-security operating costs is limited to financial reviews and audits. In addition, there is limited independent validation of ARTF spending outside of Kabul. Furthermore, the World Bank does not disseminate reports on the results and outcomes of ARTF-funded development projects to all ARTF donors.

World Bank and CAO Provide Independent Oversight of ARTF Funds

Standard World Bank policies and the ARTF grant agreement between the World Bank and the Afghan government both detail the procedures the World Bank must follow to administer and oversee ARTF funds, as well as requirements for the Afghan government to expend these funds. World Bank policies address overall requirements for trust fund administration, fund disbursement, financial management, procurement, supervision, and access to information, as well as other issues.¹⁵ The grant agreement requires the Afghan government to, among other things, follow standard World Bank procurement policies when expending ARTF funds. Further, the grant agreement and the World Bank's legal agreement with USAID state that an independent monitoring agent will review all ARTF expenditures.

The grant agreement between the World Bank and the Afghan government requires the World Bank to obtain an independent monitoring agent to monitor all operating expenditures financed by ARTF funds. In June 2002, the World Bank contracted with PricewaterhouseCoopers-Netherlands (PwC) to serve as the monitoring agent for the Recurrent Cost Window.¹⁶ The monitoring agent determines whether the Afghan government's operating cost expenditures are eligible for reimbursement from ARTF.¹⁷ The monitoring agent screens MoF's requests for reimbursement to verify that expenditures are eligible before submitting the requests to the World Bank. To provide oversight of ARTF Investment Window-funded development projects, the World Bank assigns World Bank staff to task teams for each project. These teams consist of a team leader, financial management and procurement specialists, technical experts, and other personnel, depending on the project's needs. Task teams are responsible for overseeing the implementing Afghan ministries' use of ARTF funds and ensuring that these funds are used in accordance with project grant agreements signed between the World Bank and the Afghan

¹⁴ These personnel regularly communicate with World Bank staff on ARTF issues, attend quarterly Steering Committee meetings, and participate in donor working groups. In addition, USAID personnel have participated in World Bank supervision missions for ARTF-funded projects. Other sections at the U.S. Embassy in Kabul tangentially follow ARTF.

¹⁵ World Bank's complete operational manual, including these and other policies, is available on the World Bank's Web site.

¹⁶ Following an open competition for the contract, the World Bank re-awarded the monitoring contract to PwC in 2005 and 2008, the latter of which is still in effect.

¹⁷ Under the contract, the monitoring agent is required to review the Afghan government's requests for ARTF reimbursement to ensure that funds are (1) disbursed only for the purposes provided for in the ARTF grant agreement between the World Bank and the Afghan government, and (2) used in accordance with World Bank procurement procedures and acceptable financial and auditing standards.

government.¹⁸ To accomplish this, task teams conduct supervision missions of projects at least twice a year. In addition, these task teams conduct mid-term reviews and final reviews when projects are completed. Throughout this process, the task teams produce reports for the World Bank on the status of ARTF-funded projects. In addition, the World Bank requires Afghan ministries to report to the World Bank on project implementation. The World Bank includes summary implementation status updates based on these reports in its quarterly reports to ARTF donors.

As Afghanistan's supreme audit institution, CAO is responsible for assessing ministries' financial reporting to ensure that they are in compliance with laws and regulations.¹⁹ In addition, CAO independently oversees the Afghan government's use of ARTF funds. CAO certifies the government's financial statements and conducts annual audits of the Afghan government's operating account and of accounts for projects funded by the World Bank and ARTF under the development budget. According to the ARTF grant agreement between the World Bank and the Afghan government and to CAO's mandate, the office is to audit records and accounts of all ARTF expenditures for both operating costs and development projects, and submit these audit reports to the World Bank no later than 6 months after the close of the fiscal year. In conducting these audits, CAO examines whether Afghan government expenditures are eligible for ARTF funding. Per its agreement with the World Bank, the Afghan government must refund any ineligible ARTF expenditures to the trust fund.²⁰ CAO receives technical assistance from the international auditing firm PKF International to plan and conduct ARTF audits. Appendix V provides a summary of ARTF oversight mechanisms.

Officials at the U.S. Embassy in Kabul told us that ARTF is one of the better mechanisms for providing direct assistance to the Afghan government due to the World Bank's established and standardized oversight procedures. However, these officials expressed concerns about the extent to which the World Bank is implementing its procedures to provide sufficient oversight of ARTF funds. Other donor officials indicated that the World Bank's long-established oversight procedures were key reasons why they chose to support the Afghan government via the ARTF rather than using other mechanisms. Donors also stated that in addition to providing direct assistance to the Afghan government, ARTF provides benefits such as facilitating donor coordination, serving as a platform for discussions of national policy and reform, and enabling smaller donors to be involved in decision making.

Monitoring of Recurrent Cost Window Consists Primarily of Financial Reviews and Audits

Neither the monitoring agent nor the CAO conducts performance audits to examine the efficiency and effectiveness of funding expended under the ARTF Recurrent Cost Window. Under its contract with the World Bank, the monitoring agent conducts financial reviews of Afghan government expenditures to determine whether they are eligible for reimbursement from the Recurrent Cost Window. The monitoring agent's quarterly and annual reports covering the period from March 2009 to December 2010 indicate that these procedures do not constitute an audit. PwC's contract with the World Bank does not require it to perform financial or performance audits of ARTF Recurrent Cost Window

¹⁸ The World Bank's supervision policy requires staff to (1) determine whether funds are being used to achieve development objectives, (2) identify problems and recommend solutions, and (3) highlight project risks.

¹⁹ The 1981 Afghan Control and Audit Law gives CAO, as Afghanistan's supreme audit institution, audit authority over state entities within the central and provincial governments as well as of public enterprises. The office's objectives include 1) protecting public funds and taking action against errors, irregularities, and misuse of public property; 2) preventing illegal expenditures; 3) reviewing the systems of control over government receipts and payments; and 4) guaranteeing the accuracy of aid and grants provided by donor countries.

²⁰ Since the March 2006 to March 2007 fiscal year, the Afghan government's operating costs have exceeded the maximum amount of funding available for reimbursement under the Recurrent Cost Window. As a result, CAO's findings have resulted in a substitution of the ineligible expenditures for an equal amount of eligible expenditures, rather than the Afghan government reimbursing these funds back to ARTF.

expenditures. Rather, PwC's monitoring activities are based on procedures defined in the terms of reference to its contract with the World Bank. The terms of reference require PwC to monitor all ARTF recurrent cost expenditures, monitor the Afghan government's procurements of goods and services, and review MoF's requests for ARTF reimbursement.

In accordance with its mandate, CAO, with the assistance of PKF International, conducts financial audits of all Afghan government accounts and financial statements, including the operating account, which is partially financed by ARTF Recurrent Cost Window funds. We previously reported that CAO does not conduct performance audits because it lacks the capacity to do so.²¹ While CAO has started performing some limited performance auditing, the office does not conduct performance audits of ARTF-funded accounts.

To monitor the performance of Afghanistan's core operating budget expenditures and establish a results framework for the Recurrent Cost Window, the World Bank introduced the ARTF Performance Assessment Matrix (PAM) in 2006 and began including it in quarterly donor reports in March 2008. PAM is intended to provide an assessment of the Afghan government's effectiveness by tracking trends in Afghan and donor performance across selected areas. PAM tracks the Afghan government's performance in the areas of public financial management, aid effectiveness, public administration reform, education, and health. In addition, PAM provides a platform for dialogue between donors and the Afghan government on core policy areas, and complements the ARTF Incentive Program.

Monitoring Agent, World Bank, and CAO Monitoring of ARTF Funds Expended Outside of Kabul Is Limited

Since March 2009, the monitoring agent for the ARTF Recurrent Cost Window has not conducted any site visits to the provinces. As a result, the agent has not verified first-hand approximately \$790 million of the Afghan government's non-security related payroll and operations and maintenance funds expended in the provinces. This amounted to about half of the government's total non-security related payroll and operations and maintenance expenditures from March 2009 to December 2010. The monitoring agent's contract with the World Bank specifies that the agent is expected to hire subcontractors, if necessary, to undertake specific site visits when such visits cannot be conducted by the monitoring agent.²² A senior PwC official stated that security concerns had prevented them from conducting visits to provincial government offices. In lieu of visiting provincial offices, he stated that PwC requested that ministries transfer files and supporting documents from the provinces to Kabul for review. However, during this time, CAO found that the World Bank had disbursed ARTF funds to the Afghan government for expenditures that did not comply with the grant agreement. Although World Bank officials stated that they informed ARTF donors as early as spring 2009 that the monitoring agent would not be conducting site visits outside of Kabul, donor officials we spoke to expressed concern about the monitoring agent's continued lack of provincial visits. Further, Afghan ministry officials told us that provincial and district offices have less capacity to oversee expenditures than the ministries in Kabul. Although the World Bank and PwC have taken steps to ensure that ARTF Recurrent Cost Window funds are being expended in accordance with the grant agreement between the World Bank and the Afghan government, provincial site visits may provide donors with additional assurance that these funds are being used appropriately.

²¹ See SIGAR Audit-10-8, *Afghanistan's Control and Audit Office Requires Operational and Budgetary Independence, Enhanced Authority, and Focused International Assistance to Effectively Prevent and Detect Corruption*, April 9, 2010.

²² The monitoring agent's contract also includes a clause that states that if the agent is unable to fulfill its obligations in the event of specific circumstances, such as war, civil disorder, and natural disasters, this would not be considered a breach of contract.

Despite the lack of site visits since March 2009, the World Bank did not curtail its contract with PwC nor require PwC to obtain a subcontractor to conduct provincial site visits during this time. Instead, in a modification to PwC's most recent contact signed in 2008, the World Bank nearly tripled the cumulative costs allowed to provide security from about \$700,000 to \$1.9 million.²³ World Bank officials told us that they revised the monitoring agent's terms of reference to more explicitly require site visits to the provinces, and they have yet to extend the agent's current contract for an optional third year. In May 2011, PwC told the World Bank that it does not intend to renew its current contract as the ARTF Recurrent Cost Window monitoring agent for a third year because of its concerns about security. PwC will let its contract expire in September 2011 after completing monitoring of expenditures between March 2010 and March 2011. Per its revised terms of reference, the World Bank is requiring that PwC, or its subcontractor, conduct site visits in at least 12 provinces to monitor and verify these expenditures. The World Bank has started the process of obtaining a new monitoring agent for the Recurrent Cost Window and expects the new agent to be in place by the time PwC's contract ends.

With respect to the ARTF Investment Window, we found that World Bank task teams conducted limited visits outside of Kabul during supervision missions for Investment Window-funded projects. World Bank policies require World Bank staff to monitor trust fund expenditures by evaluating results and systematically and objectively assessing ongoing or completed projects. We reviewed 14 World Bank project reports from 2008 to the present for the three largest ARTF-funded development projects—NSP, EQUIP II, and NERAP. In five cases, we noted that the teams only visited one or two provincial sites, while in six other cases the teams did not visit any provinces. In the three remaining cases, it was unclear whether teams conducted provincial visits. The extent to which World Bank task teams conducted site visits varied by project. For example, the NSP team visited four confirmed provincial sites. In contrast, the NERAP task team did not visit any provinces during its supervision mission and mid-term review conducted in late 2009 and mid-2010, respectively. The NERAP reports cited security concerns as the main reason for not visiting project sites in the provinces. In the absence of site visits, the NERAP task team had to obtain information on the status of projects from the implementing Afghan ministries and subcontractors, and did not independently verify this information. The World Bank's supervision policy does not require task teams to conduct site visits outside of Kabul during supervision missions because the goal of such missions is to engage with implementing ministries to ensure that proper project administration and monitoring mechanisms are in place. However, World Bank guidance indicates that task teams should conduct periodic visits to project sites and facilities to review progress, as appropriate. Furthermore, World Bank officials acknowledged that increased independent verification of project implementation status through provincial site visits would be beneficial.

According to World Bank officials, their task teams traveled more frequently to the provinces to independently monitor ARTF Investment Window-funded projects prior to 2009. Since then, insecurity and logistics challenges have reduced their ability to conduct visits to some provinces. World Bank officials told us that task teams based in Kabul conduct regular site visits in addition to those conducted during supervision missions. For example, although the NERAP task team's supervision missions in late 2009 and 2010 did not include provincial site visits, according to World Bank officials, the team did conduct site visits to seven locations outside of Kabul during 2010.

Although the ARTF grant agreement between the World Bank and the Afghan government and the ARTF donor framework agreement indicate that a monitoring agent was to monitor all ARTF expenditures, the World Bank only obtained a monitoring agent for the Recurrent Cost Window given the high number of transactions and level of risk, and the World Bank's existing development project supervision

²³ The actual security costs allowed in the monitoring agent's contract were 475,000 euros, which later increased to 1.35 million euros.

procedures. However, in June 2010, the World Bank began the process of obtaining a monitoring agent to expand its oversight of ARTF Investment Window-funded development projects, particularly in locations outside of Kabul. The World Bank will require the new monitoring agent to conduct site visits in all 34 provinces in Afghanistan. World Bank officials told us that they expect to award the monitoring agent contract in mid-July 2011. According to the World Bank, the contract will require the monitoring agent to focus its efforts on the three largest ARTF-funded projects—NSP III, EQUIP II, and NERAP—during the first year, with other projects added in subsequent years. Hiring a monitoring agent for the Investment Window and increasing the number of provincial site visits conducted by World Bank task teams may provide ARTF donors with further assurance that the Afghan government is using these funds as called for by ARTF grant agreements and project requirements. This is important given the continued shift in ARTF funding from operating budget support under the Recurrent Cost Window to more support for development projects funded by the Investment Window.

CAO conducted some site visits outside of Kabul while performing audits of ARTF Recurrent Cost and Investment Window expenditures. During its audit of Afghan government operating expenditures between March 2008 and March 2009, CAO auditors visited 11 out of 34 provinces, which meant that the office did not audit about \$238 million, or 28 percent, of the Afghan government's total non-security operating expenditures of \$845 million to determine eligibility for ARTF reimbursement. Similarly, due to security concerns, CAO auditors visited six provinces while conducting the audit of expenditures from March 2007 to March 2008. Because of this, CAO could not provide assurance as to the accuracy, completeness, and eligibility of transactions in the unvisited provinces. Furthermore, CAO did not independently evaluate approximately \$163 million, or 40.8 percent, of the almost \$400 million of the Afghan government's submitted operating expenditures. Moreover, in some cases, CAO auditors reviewing ARTF expenditures on NSP visited few locations outside of provincial capitals to review project expenditures. Given CAO's role as Afghanistan's supreme audit institution, increasing provincial site visits conducted during annual ARTF-related audits may provide donors with additional assurance that ARTF funds are being expended for their intended purpose.

World Bank Dissemination of Reporting on the Results and Outcomes of ARTF-Funded Development Projects Is Limited

The World Bank does not regularly disseminate reporting on the results and outcomes of ARTF-funded development projects to all ARTF donors. ARTF agreements between the World Bank and donors require the World Bank to report quarterly to donors on the status of ARTF funds. In addition, World Bank policies require the World Bank to report on whether a project's development objectives are being achieved and whether funds are being used in conformity with donor agreements. Although the World Bank reports quarterly to donors as required, these reports tend to provide more detail on the financial status of active ARTF-funded projects rather than information on project results and outcomes. We also found that while the World Bank makes a variety of ARTF-funded project reports available to the public, reports for closed projects are not consistently available. Given that ARTF projects tend to build upon other projects in the same sector, there is value in making information on closed projects, particularly the results and outcomes of these projects, publicly available. Furthermore, although the World Bank has regularly distributed task team supervision reports to ARTF donors within the sector since July 2010, other donors outside of the sector may benefit from having this information as they make funding decisions.

Several donor officials we spoke to also stated that the World Bank generally provides project documentation too late to allow them to sufficiently analyze the information before the quarterly Steering Committee meetings. For example, a senior official at the U.S. Embassy in Kabul told us that he received ARTF documentation only a few days prior to the quarterly meeting held in London in January

2010. As a result, he did not have time to thoroughly review the documents or obtain technical feedback from subject matter experts at Embassy Kabul before the meeting.

To enhance reporting on the results of ARTF-funded development projects, the World Bank recently developed a draft framework for monitoring the results of ARTF-funded development projects with the goal of helping ARTF donors and other stakeholders track the results of these projects. The proposed Investment Window results framework would aggregate project results across five sectors—rural development, agriculture, infrastructure, human development, and public sector reform—as well as cross-cutting issues of gender and connectivity. The draft framework, which the World Bank plans to update annually, will include first year, current, and target values for each indicator.

AFGHAN GOVERNMENT HAS INCREASED ITS CAPACITY TO MANAGE AND ACCOUNT FOR ARTF FUNDS, BUT CHALLENGES TO DEVELOPING AND SUSTAINING THIS CAPACITY WITHIN THE CIVIL SERVICE REMAIN

Afghan ministries receiving ARTF funds have taken steps to improve their ability to manage and account for these funds, including developing financial management and personnel tracking systems to monitor operating cost expenditures. Despite these efforts, ministries face challenges developing and sustaining capacity within the Afghan civil service. The most qualified Afghans tend to work in positions outside of the civil service. As a result, ministries continue to rely on non-civil service personnel, such as Afghan contractors and personnel employed by international firms, to manage and account for ARTF funds, particularly funding for development projects.

Afghan Ministries Have Enhanced Their Capacities to Manage and Account for ARTF Funds

The Afghan government has taken steps in key ministries to increase its capacity to manage and account for government finances, including ARTF and other direct assistance funding from donors. The MoF now tracks all Afghan government financial transactions, such as revenues, expenditures, fund disbursements, and cash transfers, through the Afghanistan Financial Management Information System, which is operational in all line ministries and in the provinces. Furthermore, the MoF has reduced the risk of fraud and corruption by using electronic funds transfers to pay many Afghan civil servant salaries.²⁴ As of March 2010, approximately 207,000, or 53 percent, of the Afghan government's approximately 390,000 non-security employees received their salaries via electronic funds transfer. The Ministry of Education (MoE) has created an employee registration database to verify the identities of, monitor, and track all ministry-employed teachers in Kabul and the provinces.²⁵ Teachers must be entered in the database in order to receive their salaries. In addition, as a result of capacity building efforts, MoE civil service personnel manage all project implementation responsibilities for EQUIP II using the ministry's financial management, procurement, and oversight mechanisms. Other ministries implementing ARTF-funded projects, such as the Ministries of Rural Rehabilitation and Development (MRRD) and Public Works (MoPW), have established program implementation units responsible for administering and managing these projects. The World Bank funds training for these program

²⁴ See SIGAR Audit-11-10, *Despite Improvements in MoI's Personnel Systems, Additional Actions Are Needed to Completely Verify ANP Payroll Costs and Workforce Strength*, April 25, 2011.

²⁵ Between March 2009 and March 2010, MoE accounted for 38 percent of non-security spending and was the largest beneficiary of ARTF Recurrent Cost Window funds. These costs were mainly for teachers' salaries as teachers account for almost half of all Afghan civil servants. MoE combined with the Ministries of Martyrs, Disabled and Social Affairs, Administrative Affairs, Public Health, Higher Education, and Foreign Affairs accounted for about 68 percent of ARTF disbursements during this same period.

implementation units and other ministry project staff in order to build Afghan capacity to manage ARTF funds in accordance with World Bank requirements.

Challenges in Developing and Sustaining Capacity within the Civil Service Result in Afghanistan's Continued Reliance on Non-Civil Service Personnel

Although the Afghan government has taken steps to increase its capacity to oversee ARTF funds, much of this capacity resides outside of the Afghan civil service. The World Bank considers various risks when proposing and implementing new ARTF-funded projects. This includes assessing the implementing agency's capacity and, if necessary, plans for enhancing this capacity. Due to the lack of capacity in many Afghan ministries, the World Bank has incorporated capacity building in ARTF-funded projects to help address this weakness. In addition, the World Bank allows ministries to use a portion of ARTF development project funds to obtain staff outside of the Afghan civil service, such as Afghan contractors or international implementation consultants. These staff provide additional expertise to manage ARTF funds and projects. For example, the international firm Deloitte Consulting Overseas Projects provides the MRRD's NSP program implementation unit with financial management assistance, and the United Nations Office for Project Services handles financial management for NERAP, which the MRRD and the MoPW implement jointly. The responsibilities of the consultants and contractors vary based on the capacity of the implementing ministry. Depending on the needs of the project, the capacity building element, which includes costs to obtain outside staff, ranges from 8 to 13 percent of total development project funding, thus decreasing the amount of ARTF funds Afghan ministries spend directly on project implementation.²⁶ In addition, CAO utilizes the international firm PKF International to provide technical assistance on ARTF-related audits. Thus, while the capacity of Afghan staff to manage ARTF-funded projects is increasing, this increase is not entirely within the Afghan civil service, and the Afghan government is not developing long-term, sustainable civil service capacity.

In addition to relying on contractor and international staff outside of the civil service, civil servants in many ministries receive salary supplements from donors to augment their civil service salaries. These supplements come in the form of incentive payments, allowances, overtime premiums, and extra payments incurred during the performance of regular duties or during regular office hours. As we previously reported, as of February 2010, the United States and the World Bank had provided an estimated \$26.4 million, or 59 percent, of the approximately \$45 million in donor salary support reported to the MoF.²⁷ Officials in the MoF told us that many personnel continue to receive salary support from the international community. One senior MoE official told us that he would not be able to remain in his current civil service position without salary support.

Afghan government officials stated that pay disparities between Afghan civil service positions and Afghans paid as contractors or consultants have made it difficult for the Afghan government to attract and retain qualified Afghan staff in the civil service. Moreover, educated and trained civil servants are likely to leave the civil service for better paying jobs as contractors or with international firms once they gain expertise. Furthermore, Afghan personnel employed by international consulting firms are not likely to seek civil service positions. A MoE official told us that many of his former colleagues in the ministry's Finance and Accounting Department left for better paying jobs with more seniority. He added that the department could fill only 122 of 257 authorized positions due to low pay and a lack of applicants with even basic qualifications.

²⁶ These figures do not include projects that are specifically designed to build Afghan capacity.

²⁷ See SIGAR Audit-11-5, *Actions Needed to Mitigate Inconsistencies in and Lack of Safeguards over U.S. Salary Support to Afghan Government Employees and Technical Advisors*, October 29, 2010.

Both the Afghan government and the World Bank are taking steps to decrease the government's reliance on contractors and international firms. For example, the MRRD is developing a plan to transition completely from contractors and international staff to civil service staff in the next 5 years. In addition, the Afghan government is continuing with efforts to implement pay and grade reform across the government with the goal of increasing civil service salaries. However, to date, these salaries remain inadequate to attract personnel with the needed skills or to compete with higher paying positions as civil servants receiving salary support, contractor positions, and positions with international consultants. In addition, during the most recent round of the ARTF Incentive Program, the World Bank included a benchmark requiring the Afghan government to report on the status of implementing pay and grade reform. Despite these efforts, World Bank and ministry officials stated that salary disparities remain a challenge to building the Afghan government's capacity in the long-term.

CONCLUSION

The United States and other donors have pledged to provide a substantial portion of development assistance through the Afghan government budget. ARTF is the main mechanism by which donors can provide direct assistance to the Afghan government. By contributing to ARTF, donors rely on the World Bank, the fund's administrator, to monitor and account for the use of contributions to the fund. This includes providing oversight of Afghan ministries receiving funds. The World Bank and the Afghan government have established several mechanisms to independently monitor and account for ARTF funds. However, opportunities exist to strengthen these mechanisms and enhance oversight of ARTF funds. The World Bank's new monitoring agents for both the Recurrent Cost and Investment Windows provide the World Bank with an opportunity to ensure that oversight of ARTF funds includes site visits to the provinces, as well as, to ministries in Kabul, and to enhance its reporting to donors on the results and outcomes of ARTF-funded development projects. Although the Afghan government has increasingly taken on more responsibility for managing and accounting for ARTF funds, ministries continue to face challenges in developing and sustaining the civil service expertise needed to manage and account for these funds. In the absence of sufficient and qualified civil service personnel, ministries have had to obtain the required expertise from civil servants receiving salary supplements and from non-civil service personnel. Furthermore, Afghan personnel employed outside of the civil service may be unlikely to seek permanent civil service positions. This could hinder the Afghan government's ability to further develop and sustain the long-term, civil service capacity needed to manage and account for development funding, including ARTF funds and other direct assistance.

RECOMMENDATIONS

To strengthen and enhance oversight of ARTF funds, we recommend that the U.S. Ambassador to Afghanistan, in coordination with other ARTF donors, urge the World Bank to:

1. Include explicit language in the new Recurrent Cost Window monitoring agent's contract and terms of reference to require the agent to make necessary arrangements to conduct site visits in both Kabul and the provinces, on a sample basis, to verify the eligibility of the Afghan government's operating expenditures.
2. Enhance reporting to all donors on development project results and outcomes by regularly including this information in its quarterly reports to donors or by systematically distributing supervision mission reports to all ARTF donors.

To ensure that Afghan ministries further develop and sustain the staff expertise needed to manage and account for development funding, including ARTF funds, we recommend that the U.S. Ambassador to Afghanistan, in coordination with the World Bank and other donors:

3. Assist the Afghan government with capacity building efforts, such as developing plans to completely transition to Afghan civil service staff and completing pay and grade reform, which would enhance the Afghan government's ability to attract and retain qualified staff.

COMMENTS

The U.S. Embassy in Kabul and the World Bank provided written comments on a draft of this report. These comments are reproduced in appendices VI and VII, respectively. The World Bank also provided technical comments, which we have incorporated as appropriate.

In its response, the U.S. Embassy in Kabul noted steps that the World Bank is taking to respond to our first two recommendations. The U.S. Embassy described several ongoing efforts to address our third recommendation to enhance the Afghan government's capacity to manage and account for development funding. For example, USAID has begun working with the Afghan Civil Service Commission to transfer contracted staff under the Afghanistan Civil Service Support program to civil service positions within the commission.

In its response, the World Bank discussed steps it is taking to respond to our three recommendations. Regarding our first recommendation, the World Bank indicated that it plans to ensure that explicit language is included in the new Recurrent Cost Window monitoring agent's contract and terms of reference to require provincial site visits. If accomplished, this will provide an additional layer of oversight of these funds. With respect to our second recommendation, the World Bank described reporting mechanisms that are already in place, such as online and paper distribution of its quarterly reports to donors and online posting of biannual project implementation status reports, and steps that it is taking to enhance reporting. The World Bank commented that we incorrectly stated that it does not regularly disseminate reporting on the results and outcomes of ARTF-funded development projects to all ARTF donors. Although we agree that the quarterly reports are available and disseminated to all donors, these reports do not include detailed information on development project results and outcomes. We discuss in the report and agree that a series of World Bank reports, such as supervisory mission reports and implementation status reports, provide valuable information on the results and outcomes of specific projects. However, we disagree that these reports are readily available to all donors. For example, supervision mission reports are routinely provided only to donors funding a particular ARTF sector and implementation status reports are generally available only for ongoing projects. We believe that it would be valuable to make information on project results and outcomes more readily available to all ARTF donors. Finally, with regard to our third recommendation, the World Bank noted the importance of building the capacity of the Afghan government. The World Bank commented that the ARTF is well placed to provide a common vehicle for capacity building and bringing salary scales in line with long-term sustainability, and discussed current plans for an ARTF-financed initiative to develop the capacity of the Afghan government.

APPENDIX I: SCOPE AND METHODOLOGY

This report provides the results of the Office of the Special Inspector General for Afghanistan Reconstruction's (SIGAR) review of the use of and accountability for U.S. funds contributed to the Afghanistan Reconstruction Trust Fund (ARTF). This report assesses the extent to which (1) the World Bank and the Afghan government have established and implemented mechanisms to independently monitor and account for donor contributions to ARTF, and (2) the Afghan government has developed the capacity to monitor and account for ARTF funds. While the ARTF has been in place since 2002, we largely limited our review to developments and oversight activities that took place from 2008 to 2011 because total U.S. contributions to ARTF from 2008 to 2011 are almost double total U.S. contributions from 2002 to 2007. With respect to ARTF-funded development projects, we focused primarily on the National Solidarity Program (NSP), the Education Quality Improvement Program (EQUIP), and the National Emergency Rural Access Project (NERAP). These are the largest ongoing projects in terms of committed ARTF funding. In addition, these projects have received 97 percent of the approximately \$542 million in U.S. contributions to the fund that have been designated for development projects. This report is one in a series of SIGAR performance audits examining U.S. and other donor assistance provided to enhance the Afghan government's oversight capacity and prevent corruption.

To assess the extent to which the World Bank and Afghan government have established and implemented mechanisms to monitor and account for donor contributions to the ARTF, we reviewed and analyzed a U.S. Agency for International Development (USAID) grant agreement, and associated modifications, with the World Bank; data detailing contributions to the fund; and U.S. foreign affairs appropriations laws and requested funding. We also reviewed various U.S. Embassy cables addressing ARTF developments and issues. In addition, we analyzed World Bank quarterly reports to donors and monthly Administrator's reports. We also examined the World Bank's ARTF grant agreement with the Afghan government; policies and procedures for financial management, procurement, and project oversight; and development project documents, including project proposals and supervision reports. We analyzed World Bank project supervision documents for NSP, EQUIP, and NERAP. We reviewed the ARTF monitoring agent's contracts with the World Bank, annual and quarterly reports from 2009 to 2010, and World Bank evaluations of the monitoring agent's performance. In February 2011, we observed two bank project oversight missions for NSP and the Kabul Urban Rehabilitation Project II, and attended a monthly ARTF Management Committee meeting. With respect to the Afghan government, we reviewed annual national budgets, development project documents, and results of the Control and Audit Office's (CAO) ARTF-related audits. We also reviewed external evaluations of the ARTF, as well as prior SIGAR audit reports on CAO²⁸ and NSP.²⁹ In addition, we interviewed U.S. officials at the embassy in Kabul representing the Office of the Coordination Director of Development and Economic Affairs, USAID, Department of the Treasury, and Rule of Law. We also interviewed officials of the World Bank, including the World Bank's Kabul-based financial management and procurement teams and task team leaders for EQUIP and NERAP, and the monitoring agent, PricewaterhouseCoopers-Netherlands. In addition, we interviewed ARTF Management Committee representatives from the Asian Development Bank, Islamic Development Bank, United Nations Assistance Mission in Afghanistan, United Nations Development Program, and the Afghan Ministry of Finance (MoF). In addition to MoF, we interviewed officials in the Afghan Ministries of Rural Rehabilitation and Development (MRRD), Public Works (MoPW), and Education (MoE), and CAO. We also interviewed Kabul-based representatives from 11 of the 32 ARTF donors, specifically Australia, Belgium, European Union, Finland, France, Germany, India, Italy, the

²⁸ See SIGAR Audit-10-8, *Afghanistan's Control and Audit Office Requires Operational and Budgetary Independence, Enhanced Authority, and Focused International Assistance to Effectively Prevent and Detect Corruption*, April 9, 2010.

²⁹ See SIGAR Audit-11-8, SIGAR released an audit report on the NSP entitled *Afghanistan's National Solidarity Program Has Reached Thousands of Afghan Communities, but Faces Challenges that Could Limit Outcomes*, March 22, 2011.

Netherlands, Norway, and the United Kingdom. As of April 20, 2011, these 11 donors and the United States accounted for almost 78 percent of ARTF contributions.

To assess the extent to which the Afghan government has developed the capacity to oversee and account for ARTF funds, we analyzed World Bank project supervision documents for NSP, EQUIP, and NERAP, and observed two bank project oversight missions for NSP and the Kabul Urban Rehabilitation Project II. We also reviewed Afghanistan's national budget, management, and development project documents. We also reviewed prior SIGAR performance audit reports on CAO,³⁰ NSP,³¹ and salary support to Afghan officials.³² In addition, we interviewed officials of the World Bank, including financial management and procurement personnel and EQUIP and NERAP task team leaders. We also interviewed Afghan government officials in the MoF, the MRRD, the MoPW, the MoE, and CAO.

We conducted work in Kabul, Afghanistan, and Washington, D.C., from November 2010 to July 2011, in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit was conducted by the Office of the Special Inspector General for Afghanistan Reconstruction in accordance with GAGAS and under the authority of Public Law No. 110-181, as amended, the Inspector General Act of 1978, and the Inspector General Reform Act of 2008.

³⁰ See SIGAR Audit-10-8.

³¹ See SIGAR Audit-11-8.

³² See SIGAR Audit-11-5, *Actions Needed to Mitigate Inconsistencies in and Lack of Safeguards over U.S. Salary Support to Afghan Government Employees and Technical Advisors*, October 29, 2010.

APPENDIX II: U.S. AND OTHER DONOR CONTRIBUTIONS TO ARTF

As of April 20, 2011, 32 donors have contributed approximately \$4.29 billion to ARTF.³³ Table I shows the top 10 ARTF donors since the fund's creation.

Table I: Top 10 ARTF Donors, as of April 20, 2011

Donor	Paid-in contributions (US\$ million)	Percent of total ARTF contributions
United States	\$972	22.6%
United Kingdom	\$862	20.1%
Canada	\$531	12.4%
Netherlands	\$355	8.3%
European Union/European Commission	\$352	8.2%
Germany	\$305	7.1%
Norway	\$241	5.6%
Sweden	\$159	3.7%
Australia	\$99	2.3%
Spain	\$85	2.0%
Total	\$3,961	92.3%

Source: World Bank ARTF Administrator's Report on Financial Status as of April 20, 2011.

As the largest donor, the United States has contributed approximately \$972 million to ARTF. About \$430 million of this has been unpreferred while the remaining \$542 million has been preferred for development projects.³⁴ About \$490 million, or 90 percent, of U.S.-preferred funds have gone to the National Solidarity Program (NSP), which aims to build local governance by setting up community development councils and training them to manage small-scale projects funded by block grants, and Community Recovery under the NSP.³⁵ Table II shows a breakdown of U.S. contributions to ARTF by funding type—preferred versus non-preferred—and development project.

³³ This includes a \$2.4 million contribution from the United Nations Development Program for the Afghan Interim Authority fund, and approximately \$21.6 million in pass-through funding to the Law and Order Trust Fund for Afghanistan.

³⁴ A preference is a formal recognition by the World Bank of a donor's decision to allocate up to 50 percent of its annual ARTF contribution to specific Investment Window-funded development projects. While the World Bank has honored all preferences to date, they are not guaranteed. The Recurrent Cost Window has priority for unpreferred ARTF funds.

³⁵ On March 22, 2011, SIGAR released an audit report on the NSP entitled *Afghanistan's National Solidarity Program Has Reached Thousands of Afghan Communities, but Faces Challenges that Could Limit Outcomes* (SIGAR Audit-11-8).

Table II: U.S. Contributions to the ARTF from March 2002 to April 2011, as of April 20, 2011

Type of funding	Contributions (US\$ million)											
	March 2002-March 2003	March 2003-March 2004	March 2004-March 2005	March 2005-March 2006	March 2006-March 2007	March 2007-March 2008	March 2008-March 2009	March 2009-March 2010	March 2010-March 2011	March 2011-March 2012	Total	
Unpreferred	\$38.0	\$20.0	\$68.8	\$60.0	\$48.9	\$0.0	\$57.0	\$102.5	\$35.0	\$0.0	\$430.2	
Preferred	\$0.0	\$0.0	\$20.8	\$2.0	\$25.0	\$0.0	\$102.5	\$161.5	\$230.0	\$0.0	\$541.8	
National Solidarity Program			\$10.0		\$25.0		\$65.0	\$160.0	\$180.0		\$440.0	
Community Recovery under NSP										\$50.0		\$50.0
National Emergency Rural Access Project				\$2.0			\$21.0					\$23.0
Education Quality Improvement Program							\$12.0					\$12.0
Microfinance for Poverty Reduction				\$5.0								\$5.0
Civil Service Capacity Building				\$4.3								\$4.3
Skills Development Project							\$3.0					\$3.0
Justice Sector Reform Project								\$1.5				\$1.5
Technical Assistance Feasibility Studies				\$1.5								\$1.5
Management Capacity Program							\$1.0					\$1.0
Rural Water Supply and Sanitation							\$0.5					\$0.5
Total ARTF Contributions	\$38.0	\$20.0	\$89.6	\$62.0	\$73.9	\$0.0	\$159.5	\$264.0	\$265.0	\$0.0	\$972.0	

Source: SIGAR analysis of World Bank ARTF Administrator's Report on Financial Status as of April 20, 2011.

Note: Contributions are based on the Afghan fiscal year, which is the solar year. The solar year begins in late March and ends late March the subsequent year. For example, solar year 1389 began on March 21, 2010, and ended on March 20, 2011.

The United States has expressed its intention to channel at least 50 percent of development funds through Afghanistan's core budget and to align 80 percent of development assistance with Afghanistan's development priorities by 2012. ARTF supports U.S. efforts to meet these objectives by funding development projects in key sectors—agriculture, governance, rule of law, and Afghan-led reintegration—that the United States has identified as critical to the Afghanistan reconstruction effort. The United States provides contributions to ARTF through a grant from USAID to the World Bank. In fiscal year 2010, the United States pledged an additional \$650 million in funding to ARTF, of which \$250 million³⁶ has been contributed as of May 2011.³⁷ USAID requested another \$650 million in its fiscal

³⁶ Of the \$250 million the United States has contributed for fiscal year 2010, USAID contributed \$200 million while the Department of Defense contributed the remaining \$50 through its Commander's Emergency Response Program.

³⁷ Per fiscal year 2010 supplemental appropriations law, Pub. L. No. 111-212, §1002 and §1004(c), and accompanying Senate report 111-188, Congress is withholding the remaining \$400 million in fiscal year 2010 ARTF funds pending a Department of State report determining whether the Afghan government is: a) cooperating with United States reconstruction and reform efforts; b) demonstrating a commitment to accountability by removing corrupt officials, implementing fiscal transparency and

year 2011 budget request and plans to request \$600 million more for fiscal year 2012. This would increase total U.S. contributions to about \$2.6 billion through fiscal year 2012. However, final funding levels will depend on Congressional approval.³⁸

other necessary reforms of government institutions, and facilitating active public engagement in governance and oversight of public resources; and c) respecting the internationally recognized human rights of Afghan women.

³⁸ The Department of Defense and Full-Year Continuing Appropriations Act, 2011, Pub. L. No. 112-10, §2122(c), includes a provision that requires the Secretary of State to suspend funding for ARTF if the department determines and reports to Congress that the World Bank monitoring agent for ARTF is unable to conduct its financial control and audit responsibilities due to restrictions on security personnel by the Afghan government.

APPENDIX III: ARTF RECURRENT COST WINDOW AND INCENTIVE PROGRAM

The Afghanistan Reconstruction Trust Fund (ARTF) Recurrent Cost Window finances the Afghan government's non-security related operating budget. This largely consists of payroll costs for Afghan civil servants as well as some expenditures for operations and maintenance, pension, and non payroll-based items.³⁹ The Recurrent Cost Window funds these costs on a reimbursable basis up to a pre-determined funding cap. In order for the Afghan government to receive reimbursement for its operating expenditures, the expenditures must meet eligibility criteria defined in the ARTF grant agreement between the World Bank and the Afghan government. As of April 20, 2011, the Recurrent Cost Window had disbursed a total of about \$1.7 billion to fund payroll and \$532 million to fund operations and maintenance expenditures (see table III).

Table III: ARTF Recurrent Cost Window Disbursements from March 2002 to April 2011, as of April 20, 2011

Operating Cost Category	Disbursements (US\$ million)										
	March 2002-March 2003	March 2003-March 2004	March 2004-March 2005	March 2005-March 2006	March 2006-March 2007	March 2007-March 2008	March 2008-March 2009	March 2009-March 2010	March 2010-March 2011	March 2011-April 2011	Total
Payroll	\$40.95	\$145.77	\$179.32	\$174.21	\$216.20	\$203.00	\$276.74	\$148.31	\$281.90	\$24.57	\$1,690.97
Operations and maintenance	\$13.65	\$51.16	\$55.28	\$79.04	\$84.01	\$87.55	\$33.32	\$73.11	\$54.78	\$0.00	\$531.91
Total	\$54.60	\$196.93	\$234.60	\$253.25	\$300.21	\$290.55	\$310.06	\$221.42	\$336.68	\$24.57	\$2,222.88

Source: SIGAR analysis of World Bank ARTF Administrator's Report on Financial Status as of April 20, 2011.

Note: Disbursements are based on the Afghan fiscal year, which is the solar year. The solar year begins in late March and ends late March the subsequent year. For example, solar year 1389 began on March 21, 2010, and ended on March 20, 2011.

In December 2008, the World Bank, the Afghan government, and ARTF donors agreed to the establishment of the Incentive Program within the Recurrent Cost Window. The objective of the Incentive Program is to support Afghan government-led reforms and the government's progress toward achieving fiscal sustainability. With the implementation of the program, baseline funding for Afghanistan's operating budget provided through the Recurrent Cost Window began to decrease by \$25 million per year beginning in March 2009. At this rate, the Recurrent Cost Window will ultimately reach zero in 2019. The Incentive Program helps to offset this decrease by providing the Afghan government with additional funds for meeting pre-defined benchmarks in such areas as revenue generation, public sector governance, and private sector development. Thus, the program places conditionality on ARTF funding. While the World Bank disburses Incentive Program funds from the Recurrent Cost Window, the Afghan government uses these funds to finance programs under its development budget.

The Incentive Program is entering its fourth round. Negotiations on new program benchmarks began in February 2011 and are expected to conclude by summer 2011. During the third round, which ended December 2010, the program offered the Afghan government up to \$70 million in incentive funds. These funds will be available for disbursement to the Afghan government from March 2011 through

³⁹ Non-payroll based expenditures are similar to operations and maintenance expenditures but directly support personnel. Such expenditures include food allowances and transportation.

March 2012. Table IV shows the amount funding for the Incentive Program from March 2008 to March 2012 as well as baseline recurrent cost funding.

Table IV: ARTF Baseline Recurrent Cost Funding, Actual Incentive Program Allocations as of May 2011, and Potential Incentive Program Allocations

	Program Year (US\$ million)				
	March 2008- March 2009	March 2009- March 2010	March 2010- March 2011	March 2011- March 2012	March 2012- March 2013
Baseline Recurrent Cost Funding	\$276	\$250	\$225	\$200	\$175
Incentive Program	\$0	\$40	\$63.8	\$70	\$70
Total Recurrent Cost Window Funding	\$276	\$290	\$288.8	\$270	\$245

Source: ARTF Incentive Program SY1389 (2010/11) Memorandum of Understanding (July 28, 2009) and World Bank responses to SIGAR questions (May 2011).

Notes: Funding for the Incentive Program is disbursed the year following when program benchmarks are to be met. For instance, World Bank disbursed funds between March 2008 and March 2009 to the Afghan government for meeting benchmarks the previous year.

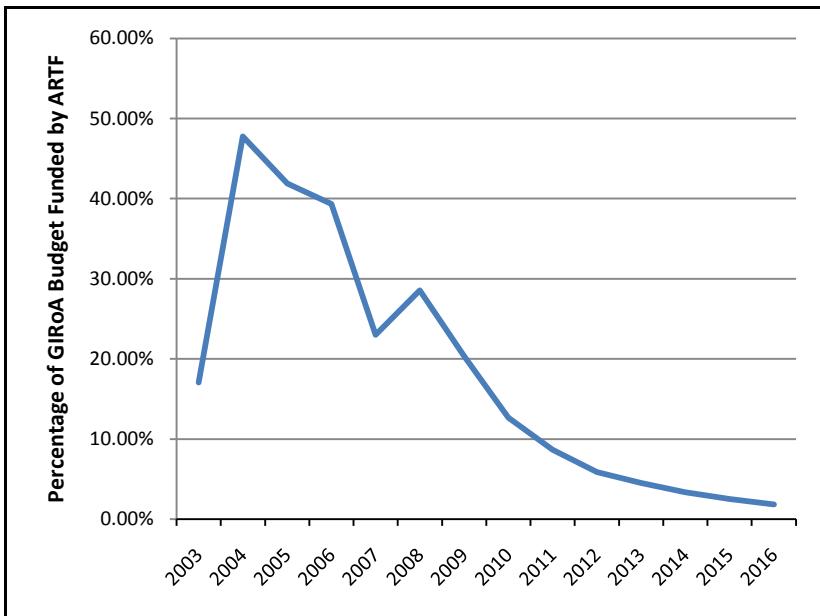
Disbursements are based on the Afghan fiscal year, which is the solar year. The solar year begins in late March and ends late March the subsequent year. For example, solar year 1389 began on March 21, 2010, and ended on March 20, 2011.

The Incentive Program has been positively received by the World Bank, many ARTF donors, and the Afghan government. Officials noted that the program provides a platform for discussing reforms within the Afghan government. The World Bank and donors are currently examining ways to reform and strengthen the program, including increasing the length of program rounds from one to three years with multi-year, rather than single-year, benchmarks. However, the lack of an International Monetary Fund Extended Credit Facility program in Afghanistan may affect the ability of the World Bank to disburse funds from the Incentive Program and may have a broader impact on donor funding in Afghanistan.⁴⁰

Since 2004, the amount of Recurrent Cost Window funding as a percentage of Afghanistan's core operating budget has decreased steadily. From March 2011 to March 2012, the ARTF is expected to fund approximately 5.9 percent of Afghanistan's total operating budget (see figure I).

⁴⁰ The IMF Extended Credit Facility program in Afghanistan, which ended on September 25, 2010, aimed at continuing the process of rebuilding key economic institutions, putting public finances on a sustainable path, and laying the foundation for economic stability and low inflation, growth, and poverty reduction. IMF did not immediately renew the program due to fallout from the Kabul Bank crisis, and is currently in negotiations with the Afghan government on a new Extended Credit Facility program. Some donors have indicated that the lack of an IMF program will make it difficult for them to continue providing development assistance to Afghanistan. To date, U.S. officials have not indicated that this will affect its funding to the ARTF in the short-term, though they are discussing the potential long-term impact on U.S. funding. Unlike other donor countries, the U.S. is not legally prohibited from providing assistance to Afghanistan without there being an ECF program in place.

**Figure I: Actual and Projected ARTF Recurrent Cost Window
Funding as a Percentage of Afghanistan's Operating Budget from
2003 to 2016**



Source: SIGAR analysis of World Bank Afghanistan Reconstruction Trust Fund Quarterly report: September 22, 2010 to December 21, 2010, and the Afghan government's 1389 National Budget Statement.

Note: ARTF funding as a percentage of Afghanistan's operating budget for the Afghan fiscal year ending in March 2012 and beyond is based on projected expenditures while prior years are based on actual expenditures.

APPENDIX IV: ARTF INVESTMENT WINDOW

The ARTF Investment Window provides grant funding for development projects that support the national priority programs defined in Afghanistan's development budget. To date, the Investment Window has disbursed a total of about \$1.31 billion to fund 34 development projects, 19 of which were ongoing as of April 20, 2011.⁴¹ With respect to overall funding commitments, the largest ongoing projects are the National Solidarity Program III, the Education Quality Improvement Program II, and the National Emergency Rural Access Project (see table V). These projects focus primarily on development in rural areas.

Table V: Total ARTF Investment Window Commitments and Disbursements from March 2002 to April 2011, as of April 20, 2011

Investment project	Total committed (US\$ million)	Disbursements (US\$ million)	Percent of committed funds disbursed
Ongoing (19)	\$793.15	\$346.31	43.7%
National Solidarity Program III	\$250.00	\$44.50	17.8%
Education Quality Improvement Program II	\$85.00	\$84.78	99.7%
National Emergency Rural Access Project	\$80.00	\$35.16	44.0%
Other projects (16)	\$378.15	\$181.87	48.1%
Closed (15)	\$962.03	\$962.03	100%
Total	\$1,755.18	\$1,308.34	

Source: SIGAR analysis of World Bank ARTF Administrator's Report on Financial Status as of April 20, 2011.

Table VI shows information on the 19 ongoing ARTF-funded development projects. The United States has provided funding to six of these projects: the Management Capacity Program, Justice Sector Reform Project, Skills Development Project, Education Quality Improvement Program II, National Emergency Rural Access Project, and National Emergency Solidarity Program III.

⁴¹ The 34 total ARTF-funded development projects include two police projects funded via a pass-through of ARTF funds to the United Nations Development Program-administered Law and Order Trust Fund for Afghanistan. In addition, some projects, such as NSP and EQUIP, have multiple phases, each of which is counted as a separate project.

Table VI: Ongoing ARTF Investment Window-funded Development Projects, as of April 20, 2011

Project	Objective	Planned closing date	Funds committed (US\$ million)	Funds disbursed (US\$ million)	Percentage of funds disbursed
Rehabilitation of Naglu Hydropower Plant	Improve reliability of the power supply in Kabul	September 2012	\$20.00	\$12.43	62%
Urban Water Supply and Sanitation	Provide urban areas with sustainable, improved water supply and sanitation services	December 2010	\$41.00	\$40.86	100%
Management Capacity Program	Improve the capacity of key government departments	December 2011	\$15.00	\$8.00	53%
Kabul-Aybak/Mazar-e-Sharif Power Project	Provide more reliable and higher quality power to Kabul, Aybak, and Mazar-e-Sharif cities	September 2011	\$57.00	\$36.71	64%
Horticulture and Livestock Program	Adopt improved practices to increase horticulture and livestock productivity	December 2011	\$34.30	\$20.40	59%
Kabul Urban Reconstruction Project	Improve delivery of basic urban services in vulnerable communities in Kabul through upgrading urban infrastructure and enhancing the capacity of Ministry of Urban Development and Kabul Municipality	December 2011	\$5.60	\$2.53	45%
Justice Sector Reform Project	Strengthen the state justice system and increase access to justice	June 2011	\$27.75	\$9.50	34%
Strengthening Higher Education Project	Restore basic operational performance at core universities in Afghanistan	December 2012	\$5.00	\$2.44	49%
Power System Development Project	Increase access to power grid and quantity of power to Pul-i-Khumri, Charikar, Gulbahar, and Jabul-Seraj urban centers	July 2012	\$60.00	\$7.89	13%
Kabul Urban Roads Improvement Project	Improve traffic flow on priority corridors of Kabul's urban roads	December 2011	\$18.00	\$9.69	54%
Water Resources Development Technical Assistance Project	Build capacity to undertake strategic basin planning and improve project preparation for water resources development	March 2011	\$5.50	\$1.09	20%
Skills Development Project	Increase access to high-quality vocational education and training in management, administration, and ICT	February 2013	\$9.00	\$7.55	84%
Second Education Quality Improvement Program	Increase access to basic education	September 2012	\$85.00	\$84.78	100%
National Emergency Rural Access Project	Increase access to services in rural areas with secondary and tertiary roads	December 2013	\$80.00	\$35.16	44%
Strengthening Health Activities for the Rural Poor	Improve the health and nutritional status of Afghans, with a greater focus on women and children and under-served parts of the country	September 2013	\$22.00	\$21.77	99%

Project	Objective	Planned closing date	Funds committed (US\$ million)	Funds disbursed (US\$ million)	Percentage of funds disbursed
On Farm Water Management Project (preparation)	Preparation grant to design project to assist farmers in adopting improved farm practices to increase agricultural production by enhancing water efficiency	June 2011	\$1.00	\$0.61	61%
Afghanistan Rural Enterprise Development Project			\$16.00	\$0.40	3%
Third Emergency National Solidarity Program	Improve local governance, reconstruct rural infrastructure	NSP II: September 2011 NSP III: September 2015	\$250.00	\$44.50	18%
On Farm Water Management Project			\$41.00	\$0.00	0%
Total			\$793.15	\$346.31	44%

Source: SIGAR analysis of World Bank ARTF Administrator's Report on Financial Status as of April 20, 2011.

Note: Projects highlighted in blue represent projects that received preferred funding from the United States.

Table VII displays 13 ARTF-funded development projects that had closed as of April 20, 2011. The United States has funded six of these projects: Technical Assistance Feasibility Studies, National Solidarity Program I and II, Education Quality Improvement Program, Rural Water Supply and Sanitation, Microfinance for Poverty Reduction, and Civil Service Capacity Building.

Table VII: Closed ARTF Investment Window-funded Development Projects, as of April 20, 2011

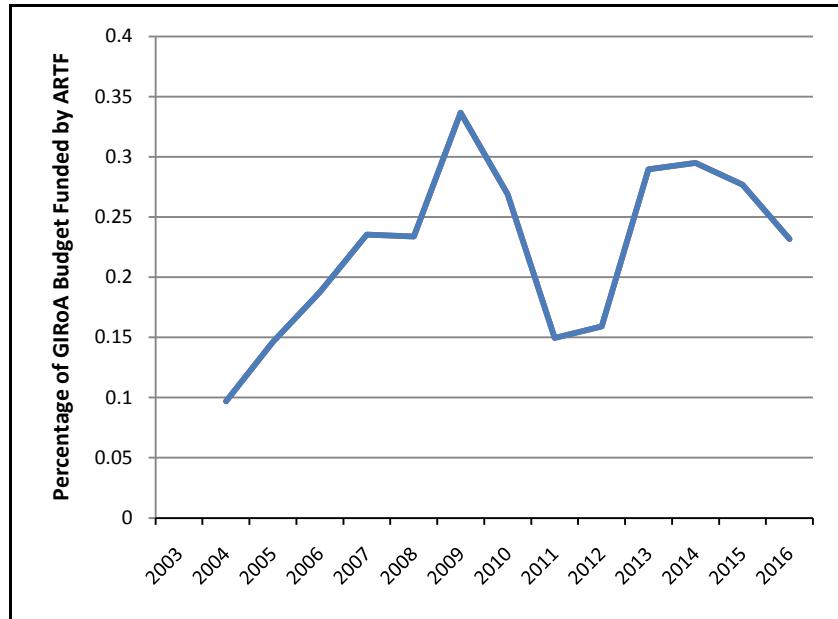
Project	Objective	Funds committed (US\$ million)	Funds disbursed (US\$ million)	Percentage of funds disbursed
United Nations Development Program Police Project 1 and 2	Not managed by the World Bank, funds passed to UNDP	\$4.84	\$4.84	100%
Technical Assistance Feasibility Studies	Build capacity of government by providing expertise to line ministries	\$16.97	\$16.97	100%
National Emergency Employment Program	Provide employment in rural areas at minimum wage	\$52.82	\$52.82	100%
United Nations Development Program Police Project 3	Not managed by the World Bank, funds passed to UNDP	\$16.80	\$16.80	100%
Telecom and Microwave Link	Rehabilitate the Ministry of Communications' communications facilities, improve revenue collection, and speed progress toward private sector telecommunications services	\$6.01	\$6.01	100%
Kabul Roads and Drainage System		\$2.80	\$2.80	100%
Kabul Power Supply	Improve availability and reliability of power supply in Kabul	\$7.43	\$7.43	100%
Strengthening Financial Capacity of the Government	Improve financial management capacities of the Ministry of Finance and select industries	\$4.06	\$4.06	100%
National Solidarity Program I and II	Improve local governance, reconstruct rural infrastructure	\$618.19	\$618.19	100%
Education Quality Improvement Program	Increase access to basic education	\$44.00	\$44.00	100%
Rural Water Supply and Sanitation	Improve rural health through provision of safe drinking water and sanitation services	\$6.23	\$6.23	100%
Microfinance for Poverty Reduction	Improve livelihoods by supporting entrepreneurial spirit and skills	\$168.94	\$168.94	100%
Civil Service Capacity Building	Meet the short-term capacity needs of the Afghan civil service	\$12.95	\$12.95	100%
Total		\$962.04	\$962.04	

Source: SIGAR analysis of World Bank ARTF Administrator's Report on Financial Status as of April 20, 2011.

Note: Projects highlighted in blue represent projects that received preferred funding from the United States. National Solidarity Program and Microfinance for Poverty Reduction funding totals combine two project phases.

Since 2003, the amount of ARTF Investment Window funding as a percentage of Afghanistan's development budget has fluctuated. From March 2011 to March 2012, the ARTF is expected to fund approximately 15.9 percent of Afghanistan's development budget (see figure II).

Figure II: Actual and Projected ARTF Investment Window Funding as a Percentage of Afghanistan's Development Budget from 2003 to 2016



Source: SIGAR analysis of World Bank Afghanistan Reconstruction Trust Fund Quarterly report: September 22, 2010 to December 21, 2010, and the Afghan government's 1389 National Budget Statement.

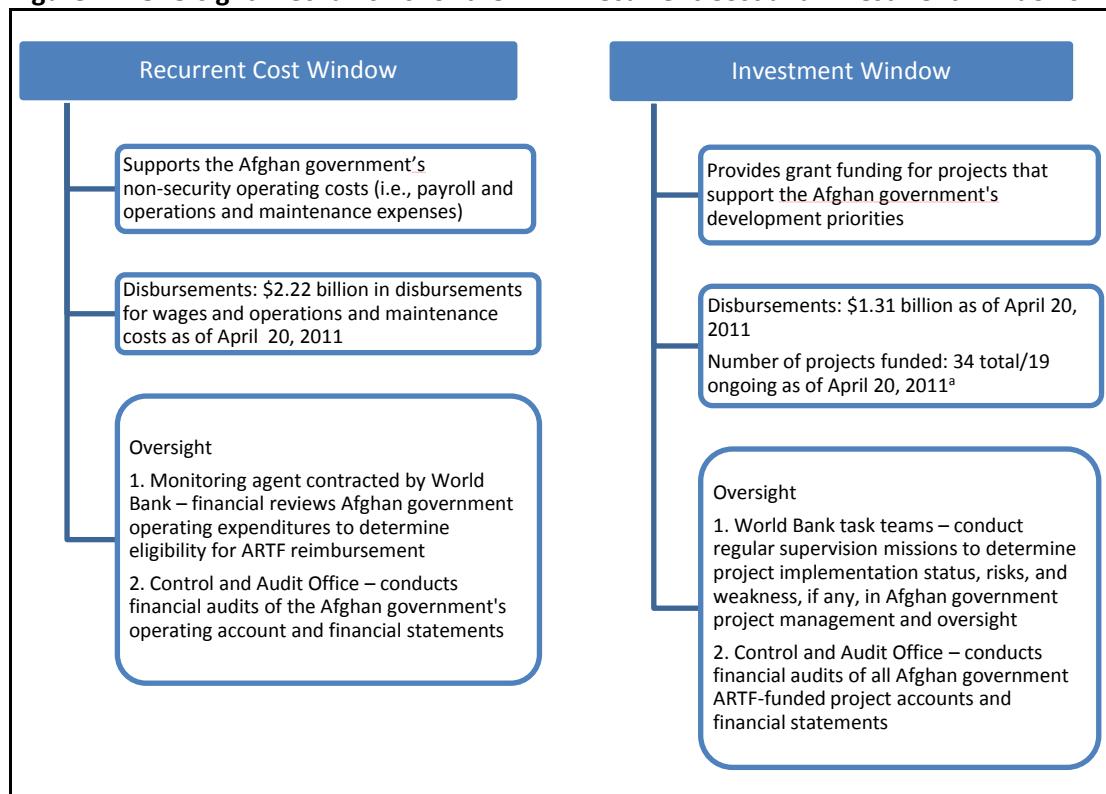
Notes: The Afghan government did not have development expenditures during its solar year ending in 2003. As a result, ARTF Investment Window funding was zero.

ARTF funding as a percentage of the Afghanistan's development budget for the Afghan fiscal year ending in March 2012 and beyond is based on projected expenditures while prior years are based on actual expenditures.

APPENDIX V: ARTF OVERSIGHT MECHANISMS

Figure III summarizes ARTF oversight mechanisms for the Recurrent Cost and Investment Windows.

Figure III: Oversight Mechanisms for the ARTF Recurrent Cost and Investment Windows



Source: SIGAR analysis of World Bank and Afghan government data.

^aSome projects, such as NSP and EQUIP, have multiple phases, each of which is counted as a separate project.

APPENDIX VI: COMMENTS FROM U.S. EMBASSY KABUL



*Embassy of the United States of America
Kabul, Afghanistan*

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DECISION MEMORANDUM

July 14, 2011

TO: CDDEA – Ambassador Richard G. Olson
FROM: CDDEA – Peggy J. Walker
SUBJECT: Response to SIGAR Audit 11-14, Afghanistan Reconstruction Trust Fund

CONTEXT

SIGAR requests Embassy response to draft Audit 11-14, “World Bank and the Afghan Government Have Established Mechanisms to Monitor and Account for Funds Contributed to the Afghanistan Reconstruction Trust Fund, but Some Weaknesses Exist.” Tab 1, compiled with input from USAID, Treasury, and INL, is our proposed response to SIGAR’s recommendations.

RECOMMENDATION

That you approve the response to SIGAR at Tab 1.

Approve PJW Disapprove _____ Let's discuss _____

2 Attachments:

Tab 1 – Draft Post Response to SIGAR Audit 11-14, ARTF
Tab 2 – SIGAR Audit 11-14

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Response to the Office of the Special Inspector General for Afghanistan Reconstruction's (SIGAR's) draft report 11-14 on: "World Bank and the Afghan Government Have Established Mechanisms to Monitor and Account for Funds Contributed to the Afghanistan Reconstruction Trust Fund, but Some Weaknesses Exist," to be issued July, 2011.

Embassy Responses to SIGAR Recommendations in Draft Report.

To strengthen and enhance oversight of ARTF funds, we recommend that the U.S. Ambassador to Afghanistan, in coordination with other ARTF donors, urge the World Bank to:

Recommendation #1: Include explicit language in the new Recurrent Cost Window monitoring agent's contract and terms of reference to require the agent to make necessary arrangements to conduct site visits in both Kabul and the provinces, on a sample basis, to verify the eligibility of the Afghan government's operating expenditures.

Embassy Response to Recommendation # 1: The World Bank confirms that it already has revised the TOR (Tab 1) for the recurrent cost window monitoring agent (MA), to more explicitly require provincial site visits aside from Kabul. The current ARTF Recurrent Cost Window MA is required to conduct at least 12 provincial site visits for monitoring and verifying the Afghan Government's SY 1389 (March 2010-March 2011) operating expenditures. The TOR also requires verification of transactions through site visits and sampling for each category of expenditures including salaries and other recurrent costs.

Recommendation #2: *Enhance reporting to all donors on investment project results and outcomes by regularly including this information in its quarterly reports to donors or by systematically distributing supervision mission reports to all ARTF donors.*

Embassy Response to Recommendation #2: At the technical level, weekly reports (and daily updates on request) are provided to donors by the ARTF program managers and by key project managers, including in particular for the National Solidarity Program (NSP) to which the USG is the largest contributor. In addition, as a significant historic contributor to the World Bank's ARTF, the U.S. is invited to participate in World Bank Supervisory Missions to NSP project sites and, together with other donors, is provided with a copy of the Implementation Support Mission Aide Memoire. The most recent Aide Memoire is dated June 29, 2011 and is for the period May 15-31, 2011. At the senior management level, ARTF donors meet quarterly to discuss broader ARTF strategy and results to date with the Afghan Government and with the ARTF Management Committee which includes the World Bank, the Islamic Development Bank, the Asian Development Bank, and the UN. To further enhance reporting to all donors on investment project results and outcomes, the World Bank is establishing a website for reporting on all ARTF development projects and is in the process of hiring a monitoring agent for the Investment Window. The competitive process for the Investment Window monitoring agent has

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been finalized and the contract is being negotiated. The World Bank expects to be able to announce the new monitoring agent and to commence the work by August 1, 2011. Tab 2 is the TOR for the Investment Window Monitoring Agent.

To ensure that Afghan ministries further develop and sustain the staff expertise needed to manage and account for development funding, including ARTF funds, we recommend that the U.S. Ambassador to Afghanistan, in coordination with the World Bank and other donors:

Recommendation #3: Assist the Afghan government with capacity building efforts, such as developing plans to completely transition to Afghan civil service staff and completing pay and grade reform, which would enhance the Afghan government's ability to attract and retain qualified staff.

Embassy Response to Recommendation #3: The Embassy continues to support Afghan government capacity building efforts through both its off-budget programs and its planned on-budget efforts. The Embassy is currently implementing programs to improve central government civil service corps and municipal government administration that include support for pay and grade reform. Additionally, the Embassy, thorough USAID, has begun working with the Civil Service Commission (CSC) in transferring contracted staff under the Afghanistan Civil Service Support (ACSS) program to the CSC tashkil (Dari word meaning "organization.") The Embassy will soon provide on-budget support to the CSC in order for the CSC to sustain the implementation of activities under ACSS, including holding job fairs to attract qualified applicants and offering professional development courses to retain staff.

The Embassy's Justice Sector Support Program (JSSP) advisors and mentors have been embedded with the Ministry of Justice (MOJ) since 2007 and with the Attorney General's Office (AGO) since 2010. These embedded technical advisors and mentors comprise the policy and planning (or strategy) units for both Justice institutions. The scope of work dictates that the units are to bolster immediate capacity at the institutions, build capacity for other employees over time, and eventually merge into units or departments within the institutions. As capacity increases, it is anticipated that the units will merge under established transition timetables. Additionally, JSSP has dedicated one advisor to assist the international effort, led by Adam Smith International, in implementing pay and grade reform at the Attorney General's Office.

The Embassy's INL Corrections System Support Program (CSSP) works with the Central Prison Directorate (CPD) to monitor compliance or non-compliance issues concerning the pay and grade reform process. Meetings between the CPD and CSSP are routinely held to discuss non-compliance trends, and resolve each issue. Currently, CSSP and CPD are working together to review all positions to ensure they are filled by a qualified individual.

The Embassy has had a fulltime capacity advisor assigned to the Ministry of Counternarcotics for one year. The advisor oversees a team of Afghans who will be building capacity in the areas of finance, communications, human resources, and policy. Some of our accomplishments to date

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include: the hiring of Afghan advisors, implementing an intern program, creating filing systems, creating a ministry ID/employee registration system for staff members, and supplying office equipment.

Attachments:

- 1) Terms of Reference – Recurrent Cost Window Monitoring Agent
- 2) Terms of Reference – Investment Window Monitoring Agent

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APPENDIX VII: COMMENTS FROM THE WORLD BANK

The World Bank

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

19, Street 15
Wazir Akbar Khan
Kabul, Afghanistan

Tele: (0700) 27 6002
WBN: 5232 + Extension
WBN Fax: 5232+350

July 15, 2011

To: Special Inspector General for Afghanistan Reconstruction

Re: World Bank Response to SIGAR Audit of the ARTF

On behalf of the World Bank, I would like to thank the SIGAR team for their professional and consultative approach in carrying out the audit of the Afghanistan Reconstruction Trust Fund (ARTF). The SIGAR team is especially to be thanked for seeking comments, many of which were taken into account, in finalizing its Report.

The administration of the ARTF has been and remains central to the World Bank's mission in Afghanistan and we are proud of the partnership that it has forged with ARTF donors, with the Afghan government and with the beneficiaries. Thanks to the sustained engagement of donors, and in particular the US government which is now the largest contributor to the fund, the ARTF has delivered tangible and widespread benefits to the Afghan people while ensuring a robust framework for fiduciary and technical oversight. The three projects that SIGAR chose to feature in this review (EQUIP, NSP and NRAP) have yielded some of the fund's most impressive development results. However, because SIGAR must limit itself to the fiduciary characteristics of the ARTF, it cannot give readers a sense of the operational challenges or of the impressive results that have been achieved.

As the Report concludes, the US and other donors have pledged to direct more of their development assistance to Afghanistan through the Afghan budget and that the ARTF is the main mechanism by which donors can put aid on budget in a way that meaningfully delivers development outcomes. We appreciate the acknowledgement that ARTF has in place a set of mechanisms to monitor and account for funds.

The ARTF is part of the global "Single Audit" of all trust funds administered by the World Bank, and includes both an annual management assertion over internal controls surrounding the preparation of trust fund financial reports, and a combined financial statement for all modified cash basis trust funds. In addition, ARTF-financed activities are subject to a layered fiduciary framework within Afghanistan. First is the Ministry of Finance's leadership in establishing, implementing and enforcing a robust and centralized control framework including a transparent and comprehensive budget, treasury operations, procurement oversight and audits all supported by either World Bank or other donor-financed technical assistance. This framework covers all donor funds that flow through the Core Budget and is subject to continual review, evaluation and oversight. A second layer, applied only to funds for which the Bank acts as administrator, is the Bank's own role in supervising ARTF projects according to our legal agreements with both donors and the government. This layer includes regular financial management reviews, a procurement review of contracts, checks on disbursement, audit and monitoring of development outcomes.

Finally, over the last ten years, the Bank's work in Afghanistan has enabled us to calibrate both the design and supervision of ARTF operations to the changing environment on the ground. Operating in Afghanistan is extremely difficult, not least because of the security situation, and therefore innovative techniques have been required in order to enhance

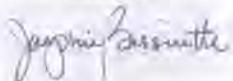
oversight. ARTF projects are designed either around community implementation and monitoring or around contracted oversight by facilitating partners, financial management firms or technical agencies that support the management of government contracts. In recent years the Bank has also increased the use of independent impact evaluations, third party monitoring and hand-held devices for infrastructure mapping. In August 2011, the nationwide deployment of a monitoring agent for ARTF investments will add a further layer to an already sound framework for donor funds. We note that while acknowledging the strengths of the framework, the SIGAR report points to parts of the framework that they believe could be further improved. We address these points in the Annex to this letter.

The SIGAR Report makes 3 specific recommendations on which we also wish to comment:

1. **Include explicit language on provincial site visits in the text of the new monitoring agent contract.** As we informed the SIGAR auditors, the Bank is in any case planning to ensure that terms of reference for the new Monitoring Agent are explicit with regards to provincial site visits. Provincial site visits would provide the basis for additional comfort over and above the strict requirements of ensuring fiduciary control on recurrent cost funds which we describe in more detail in the Annex.
2. **Enhance reporting to all donors on investment project results and outcomes.** Donors and other interested stakeholders currently access an unprecedented range of financial and developmental information on ARTF-funded activities that far exceeds the requirements set out in our agreements with donors. In fact, all Bank task teams complete twice a year an Implementation Status Report (ISR) on the results achieved under the projects. These ISRs are posted online and are therefore available to all donors. The ARTF quarterly reports are also available both online and are sent to all embassies and Executive Director's offices in Washington. For donors that request it, the World Bank technical teams provide copies of the Aide Memoires provided to the Afghan government following supervision missions of individual projects under the ARTF. Although already providing access to this wealth of information, the Bank is introducing additional enhancements as set out in the Annex.
3. **Assist the Afghan government with capacity building efforts.** As an on-budget and multi-donor mechanism, the ARTF is well placed to provide a common vehicle for capacity building and bringing salary scales in line with long run sustainability. For this reason, the Bank has been preparing a major new, multi-year ARTF-financed initiative for capacity development in Afghanistan called the Capacity Building for Results Facility (CBR). CBR aims to significantly increase the capacity of government to deliver essential services and implement national priority programs, while helping address the over reliance on external technical assistance. The Bank appreciates the confirmation from USAID that support for this important program will be provided through its participation in ARTF rather than through separate bilateral assistance.

The ARTF represents, in our view, one of best models of successful donor-Government collaboration that is delivering real results for Afghans across the country. As the country takes on greater responsibility for its development, we hope to work with our donors to ensure the ARTF can continue to provide a sound and effective mechanism for the management of international assistance and the delivery of essential services and sustainable infrastructure in Afghanistan.

Sincerely,



Josephine Bassinette
Acting Country Director for Afghanistan
South Asia Region

ANNEX

Despite the strengths of the ARTF structure, SIGAR has pointed out what they believe are certain weaknesses in the framework and makes recommendations for further strengthening. The following briefly addresses some of these points raised in the Report.

ARTF Recurrent Cost window oversight

The SIGAR Report concludes that there are limitations in the World Bank mechanisms for the oversight of the use of ARTF-funded recurrent costs. The reasons given for this conclusion are that the oversight does not include performance audits and that the Monitoring Agent has not conducted site visits outside of Kabul since March 2009 and the Control and Audit Office (CAO) audits do not cover all the provinces.

The World Bank oversight arrangements have consistently allowed the Bank to fulfill its fiduciary responsibility which is to ensure due and economic use of funds provided. To this end the Bank assessed the strength of the Government's own controls over expenditure, provided technical assistance to improve these controls and agreed with Government on additional measures of independent verification. The independent verification by the Monitoring Agent and the CAO established that uses under the ARTF recurrent cost fund were made for authorized purposes by examining internal and external evidence supporting the expenditure and by establishing that the agreed procurement procedures were followed, which imply that fair and economic procurement was carried out. Moreover, ARTF funding of recurrent budget expenditures is only made following the World Bank and IMF review of the budget framework so performance audits of recurrent expenditures are not necessary to fulfill the Bank's fiduciary responsibility.

Similarly, the Monitoring Agent's work established that submitted expenditures contain eligible expenditures in all years which exceed the ARTF disbursements under the recurrent cost window. Similarly, the CAO provided positive assurance on expenditures in excess of the ARTF disbursements. Any monitoring or external audit of the remaining operating expenditures which are not financed by ARTF funds is not part of the Bank's fiduciary responsibility under the ARTF.

A critical point not made clear in the Report is that the ARTF recurrent cost window, thanks to the Monitoring Agent's work, does not reimburse any expenditure that is ineligible.

World Bank Supervision of the Monitoring Contract

The SIGAR Report indicates that despite the lack of site visits since March 2009, the World Bank did not curtail its contract with PwC nor require PwC to obtain a subcontractor to conduct provincial site visits during this time.

There was no basis for cancellation of the contract as the World Bank accepted the Monitoring Agent's approach to monitoring. There was intense analysis of the provincial coverage by the Monitoring Agent and extensive discussion with the firm, the World Bank and the Ministry of Finance on the issue and on how to effectively monitor provincial operations. In order to complete the monitoring on a timely basis, the transmission of documents was agreed and applied on a basis where travel would not endanger staff.

The SIGAR report also notes that the World Bank increased the contract value instead of cancelling the Monitoring Agent contract. This modification arose from the need to provide additional security for the staff who operate out of Government offices and was based on their firm's security assessment in the wake of the attack on the Ministry of Finance in January 2010 in which Monitoring Agent staff were directly caught up without support. This cost increase was in line with provisions provided for all international firms operating in Afghanistan.

ARTF Investment Window oversight and reporting

The SIGAR report concludes that opportunities also exist to strengthen the World Bank oversight and supervision of the investment window. In particular, SIGAR finds that the Bank should field increased project site visits. However, SIGAR considered only site visits that took place at the time of the bi-annual supervision missions of NERAP, NSP and EQUIP, whereas World Bank task teams make site visits throughout the year and not just during the formal supervision missions. Site visits, therefore, are under-reported by SIGAR.

Site visits are just one of the many ways in which teams provide project supervision. The core objectives of supervision are to ensure that funds are expended for the purposes intended, to ensure agreed-upon project implementation arrangements are being followed and to monitor progress against development objectives. The design of ARTF projects builds in accountability and oversight. EQUIP, NSP and NRAP are good examples: communities are responsible for much of the project implementation and community monitoring. Oversight is provided by Facilitating Partners in the case of NSP, and UNOPS in the case of NRAP. Meanwhile government is responsible for managing and overseeing contracts, reporting on implementation and managing the funds in accordance with its legal agreements with the World Bank. World Bank supervision focuses on ensuring that these arrangements are in place and functioning as designed. This multi-layered system is built into the project design for ARTF projects to account for the high risk environment and the difficulties in carrying out site visits in parts of the country where it is extraordinarily difficult for Bank staff to operate with an acceptable level of safety.

In addition, and as the SIGAR report notes, the World Bank is now in the process of contracting with a third party monitoring agent for the whole ARTF investment window. This is expected to be up and running as of August 2011. The third party will be in a position to provide oversight and verification of ARTF-financed assets across the country. Bank technical teams will work with the agent to set out the terms of reference for specific program oversight and the agent will also be working with the Afghan government to ensure capacity is transferred. This arrangement will provide oversight that is almost unique in the Bank.

With regard to reporting, the Report erroneously claims that the Bank does not "regularly disseminate reporting on the results and outcomes of ARTF-funded development

projects to all ARTF donors". In fact, Implementation Status Reports (ISR) on the results achieved under all the projects are completed and made public twice a year. The ARTF quarterly reports are also available both online and are sent to all embassies and Executive Director's offices in Washington. For donors that request it, the World Bank technical teams provide copies of the Aide Memoires provided to the Afghan government following their supervision missions. These are not currently provided to all donors because they are highly technical records of project supervision intended mainly for the government. They are currently shared with donors that are able to join and provide technical inputs to supervision missions.

ARTF donors have access to full and proper reporting according to the Bank's own disclosure policies as well as its agreements with the donors. Nevertheless, the Bank is working to improve even more on its reporting to ARTF donors including creating a dedicated site so that all ISRs, project papers and other relevant information on all ARTF-financed activities are available in a single location. A commonly-agreed results framework for ARTF activities is also being finalized.

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- improve effectiveness of the overall reconstruction strategy and its component programs;
 - improve management and accountability over funds administered by U.S. and Afghan agencies and their contractors;
 - improve contracting and contract management processes;
 - prevent fraud, waste, and abuse; and
 - advance U.S. interests in reconstructing Afghanistan.
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